

E-015/GR-87-223 APPROVING AND CLARIFYING AFPO AGREEMENT

BEFORE THE MINNESOTA PUBLIC UTILITIES COMMISSION

Barbara Beerhalter	Chair
Cynthia A. Kitlinski	Commissioner
Norma McKanna	Commissioner
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In the Matter of the Petition of Minnesota Power and Light Company, d/b/a Minnesota Power, for Authority to Change its Schedule of Rates for Retail Electric Service in Minnesota

ISSUE DATE: September 8, 1989

DOCKET NO. E-015/GR-87-223

ORDER APPROVING AND CLARIFYING
AFPO AGREEMENT

PROCEDURAL HISTORY

On March 1, 1988 and May 16, 1988, the Minnesota Public Utilities Commission (the Commission) issued its final Orders establishing rates in this docket. On October 19, 1988, Minnesota Power and Light Company (MP, Minnesota Power or the Company) filed a Petition to Amend Orders to Suspend AFPO Credit with the Commission. MP asked the Commission to amend its March 1, 1988 and May 16, 1988 Orders to suspend the AFPO credit, increasing rates approximately 3 per cent. MP also proposed that the AFPO credits already flowed through to ratepayers be accumulated for recovery in the next rate case.

On January 11, 1989, the Commission issued its ORDER DENYING PETITION WITHOUT PREJUDICE in this docket. The Commission found that it could not determine whether MP's rates were inadequate by looking at the AFPO credit in isolation.

On January 31, 1989, MP filed its Petition for Reconsideration of the Commission's January 11, 1989 Order. The Commission issued its ORDER GRANTING AND SUSPENDING PETITION FOR RECONSIDERATION on February 21, 1989. That Order granted MP's January 31 petition for reconsideration, but deferred consideration on the merits until after a determination is made in this matter. On February 22, 1989, the Commission issued its ORDER VARYING TIME TO ANSWER PETITION FOR RECONSIDERATION.

MP filed the Joint Petition of Minnesota Power, the Department of Public Service (DPS or the Department), the Residential Utilities Division of the Office of the Attorney General (RUD-OAG), and the Taconite Intervenor for Approval of an Agreement Regarding AFPO (AFPO Agreement)

on February 21, 1989.

On March 3, 1989, the Commission noticed interested parties of the April 7, 1989 deadline for filing comments and the April 17, 1989 deadline for filing replies.

Comments in support of the AFPO Agreement were filed by the RUD-OAG on March 21, 1989, by the DPS on April 6, 1989, and by MP on April 7, 1989.

Superwood Corporation (Superwood) filed comments opposing the AFPO Agreement on April 10, 1989. Superwood recommended that the AFPO Agreement not be approved and that MP be required to stop booking AFPO credits and amortize the AFPO balance over the remaining useful life of Boswell 4.

Replies to Superwood's comments were filed by the RUD-OAG and MP on April 17, 1989, and by Hibbing Taconite Joint Venture, Inland Steel Mining Company, National Steel Pellet Company, USX Corporation and Eveleth Mines (Taconites), and the DPS on April 18, 1989.

Superwood filed its reply to MP's comments on April 19, 1989.

The Commission issued its ORDER DEFERRING INVESTIGATORY PROCEEDINGS in In the Matter of Minnesota Power & Light Company's Sale and Northern States Power Company's Purchase of Forty Percent Undivided Ownership Share in the Boswell Steam Electric Generating Station Unit No. 4 Facilities, Docket No. E-002,015/PA-86-722 (the Sale Docket) on June 12, 1989.

The Commission met on June 8, 1989 to consider the AFPO Agreement.

FINDINGS AND CONCLUSIONS

BACKGROUND

The Commission recognized the concept of an allowance for plant being phased-out (AFPO) in the Sale Docket.

In the Sale Docket, Minnesota Power proposed to sell and Northern States Power Company (NSP) proposed to buy a 40% interest in MP's Boswell 4 generating station together with leases of transmission, capacity and energy. The transaction was to be completed in installments on May 1, 1989, 1990, and 1991. The gain on the sale of Boswell 4 totalled approximately \$31.1 million. MP proposed that the gain be recognized for financial reporting and ratemaking purposes, prior to the actual receipt of the gain, over the period of July 1, 1987 through 1991. This advance recognition of the gain for ratemaking and for financial reporting is a primary component of the concept of

AFPO.

The sale was conditioned upon certain regulatory assurances from both the Commission and from the Federal Energy Regulatory Commission (FERC).

The Commission approved the sale and authorized AFPO in its June 23, 1987 ORDER APPROVING TRANSFER OF PROPERTY AND RATEMAKING TREATMENT in the Sale Docket. On June 23, 1987, the Commission issued its ORDER FOR INVESTIGATIONS in the Sale Docket which provided for investigatory proceedings to examine the financial impact of the sale on MP.

The Commission recognized AFPO in this docket, the Company's last general rate case. In the Matter of the Petition of Minnesota Power & Light Company, d/b/a Minnesota Power, for Authority to Change Its Schedule of Rates for Retail Electric Service in the State of Minnesota, Docket No. E-015/GR-87-223 (March 1, 1988). Incorporating the AFPO credit into rates reduced MP's annual revenue requirement by approximately \$8.8 million and has been reflected in MP's rates since July 1, 1987.

In Orders issued April 21, 1988, June 22, 1988, and August 9, 1988 in FERC Docket No. EL87-65-000, FERC declined to provide NSP with the ratemaking assurances NSP believes are necessary for its purchase of Boswell 4.

On July 19, 1988, NSP sought a ruling from the Hennepin County District Court that the Boswell sale and purchase contracts are null and void. That matter is pending.

On August 19, 1988, MP appealed FERC's decisions to the U.S. Court of Appeals. That matter is pending.

MP's rates have been adjusted to reflect a reduction in annual revenue requirement of approximately \$8.8 million due to the recognition of the AFPO credits. Since July 1, 1987, ratepayers have paid rates which collect \$8.8 million less in annual revenues and continue to pay those rates. The sale of generating plant which was to give rise to the gain on sale upon which the AFPO credit is based is now subject to litigation and substantial uncertainty. There is no certainty that the sale of generating plant will be consummated and the gain received by MP.

The AFPO Agreement primarily establishes accounting mechanisms which would accumulate the AFPO credit included in rates in certain accounts. Balances in those accounts would be offset with certain incremental sales revenue and gains on sales of generating plant. As a result, there would be no immediate change in rates.

The parties to the AFPO Agreement believe that it achieves the following goals:

1. Holding retail rates at their current levels at least through 1989 and eliminating any AFPO-related inducement to raise rates in 1990;
2. Giving MP a reasonable opportunity to recover, over time, the AFPO credits it has

already or soon will have passed through to its customers in expectation of the sale of Boswell 4;

3. Creating a strong incentive for MP to continue to make equity sales of plant facilities either to NSP or to other parties;
4. Creating an incentive for MP to make additional power sales (either on-system or off-system); and
5. Giving MP a reasonable length of time to attempt to make such sales so that there will be a high probability that retail electric rates will never have to be increased merely to recover revenue shortfalls created by the elimination of the AFPO credits.

DESCRIPTION OF THE AFPO AGREEMENT

The Commission will first discuss the major features of the Agreement. The AFPO Agreement proposes two separate AFPO Accounts: AFPO Account I and AFPO Account II.

AFPO Account I

AFPO Account I includes the AFPO credits occurring after June 22, 1988, the date that the FERC issued its Order Denying Rehearing of NSP's request for regulatory assurance. AFPO Account I will be recovered through incremental capacity-related revenue. Also, gains on sale of generating plant can be used to retire AFPO Account I, after they have been used to fully retire AFPO Account II. Often, the revenues from increased sales in the period between rate cases flow to shareholders. Under the AFPO Agreement, some of the revenues from sales above the level established in the last rate case will instead be applied to recover the AFPO credit reflected in rates.

In rate cases with interim rates becoming effective from January 1, 1991 to January 1, 1996, the AFPO Agreement excludes the AFPO Account I balance and certain incremental capacity-related revenues from such rate cases. In rate cases with interim rates effective after January 1, 1996, 90 per cent of any remaining balance in AFPO Account I will be included in revenue requirement calculations.

AFPO Account II

AFPO Account II accumulates those AFPO credits flowed through to ratepayers from July 1, 1987 to June 22, 1988. The balance in AFPO Account II can be recovered only through gain on the sale of plant, or through incremental capacity-related revenues after AFPO Account I has been fully retired. No portion of AFPO Account II can be included in revenue requirements in future rate cases.

Other Provisions

In the Sale Docket, the AFPO credit was calculated to be a declining amount over the period that the sale of a portion of Boswell 4 took place. Schedules attached to the AFPO Agreement estimated the Minnesota jurisdictional retail reduction in rates due to the AFPO credit at \$8.8 million for the year July 1, 1987 through June 30, 1988. The amount was estimated at \$6.6 million for the year 1989 and \$3.7 million for the year 1990. Because the test year in the last rate case was July 1, 1987 through June 30, 1988, the \$8.8 million amount was the amount included in rates. The \$8.8 million amount included in rates continues until a subsequent rate case.

The AFPO Agreement provides that a rate case cannot be filed with interim rates effective in 1989. This provision assures that rates cannot increase in 1989, thereby preserving a \$2.2 million benefit for ratepayers (\$8.8 million minus \$6.6 million). A rate case could be filed with interim rates effective in 1990, but the AFPO Agreement would require a transfer of up to \$5 million from AFPO Account I to AFPO Account II which could not be recovered by MP.

ISSUE

The Commission must determine whether the accounting mechanisms and other provisions of the AFPO Agreement are reasonable under the circumstances presented here.

The Commission finds that the Agreement fairly balances the interests of the Company and its ratepayers. The accounting procedures embodied in the AFPO Agreement allow the Company to recover AFPO credits over a period of years and encourages MP to make additional power sales and additional sales of plant. Further, the AFPO Agreement maintains current rates, recognizes increased sales occurring after the test year, maintains rate stability, avoids the costs and administrative burdens of a repetitive rate proceeding which could undo the rate structure which the Commission painstakingly established earlier in this proceeding. The Commission will therefore approve the AFPO Agreement subject to the clarification below.

Turning to the specific provisions of the AFPO Agreement, the Commission finds that June 22, 1988 is a reasonable date to begin AFPO Account I because that is the date of the FERC Order denying NSP's request for regulatory assurance that the acquired capacity would be prudently included in its rate base and therefore the date the sale was became less certain.

The Commission further finds that it is reasonable to retire AFPO Account I through incremental capacity sales revenues and to apply gains on sales of generating plant to retire AFPO Account I only after such gains have been applied to retire fully AFPO Account II. Normally, revenues from increased sales between rate cases flow to shareholders. Under the AFPO Agreement, some of the revenues from sales above the level established in the final Order in this case will be applied to reduce AFPO credit benefiting ratepayers by discouraging the filing of a rate case before the beginning of 1991.

The Commission also finds reasonable the exclusion of unretired AFPO Account I balances and certain incremental capacity related sales revenues from any rate case filed before January 1, 1996. For any rate case filed after that date, only 90% of the unretired balance in AFPO Account I will be considered. This provision is reasonable in order to allow MP a reasonable amount of time to implement the Agreement and make the additional sales. Since MP is guaranteeing that it will not file a rate case with interim rates effective in 1989 and since the Agreement provides disincentives to file a rate case before January 1, 1991 in order to make up the deficiencies caused by the AFPO shortfall, it is only fair, just and reasonable that it not be subject to rate reductions after that time where it is successful in marketing incremental sales.

Conversely, the Commission finds that the Agreement creates a strong incentive for MP to make incremental capacity sales or sales of the plant as quickly as possible in order to begin to recover the amounts set aside in AFPO Account II. The longer MP delays capacity or power sales up to and including January 1, 1996 to retire AFPO Account I, the less likely any amount in AFPO Account II will be recovered because no amounts in AFPO Account II may be recovered after January 1, 1996. Accordingly, the Commission finds that there is a high probability that retail electric rates will never have to be increased merely to recover revenue shortfalls created by the elimination of the AFPO credits.

The Commission also finds the AFPO Account II provision reasonable. The balance of approximately \$8.6 million represents those AFPO credits prior to the date of FERC's denial of regulatory assurance regarding the sale. It is appropriate that MP should bear the risk of loss for that period because until FERC's denial, it had voluntarily sought to include the AFPO credits in rates

before actually having received any payments under the contract.

Other Terms

The AFPO Agreement also includes provisions for reporting, withdrawal of MP's request for reconsideration of the Commission's January 11, 1989 Order, and cancellation of the three investigations established in the Sale Docket and scheduled for May 1, 1989, May 1, 1990, and May 1, 1991.

The Commission finds reporting necessary in order to monitor the progress and effects of the AFPO Agreement. The Commission will accept MP's withdrawal of its petition for reconsideration recognizing that it is moot upon approval of the AFPO Agreement.

The investigations ordered in the Sale Docket are unnecessary since the sale has not occurred and have already been deferred by Commission Order dated June 12, 1989 in the Sale Docket.

Clarification

The AFPO Agreement does not address what happens if the sale of Boswell 4 to NSP or another party takes place after some accumulated AFPO credits are retired.

The Commission will not allow a double-recovery under the AFPO Agreement. To protect the interests of ratepayers, the Commission finds that it must clarify the AFPO Agreement to require that should the sale of generating plant take place to NSP or other party, the status of the AFPO Accounts and the gain realized on the sale will be reviewed by the Commission, the Department and other interested parties to assure the proper distribution of the gain.

The Commission concludes that, as clarified, this Agreement is reasonable to ratepayers and to MP. It assures rate stability, mitigates customer confusion, and preserves benefits for ratepayers, while allowing MP the opportunity to recover the AFPO credits.

Other Considerations

The Commission considered ordering MP to file a general rate case as a possible solution to the failure to realize the actual cash flows from the sale of Boswell 4. The parties have argued in support of the Agreement that a general rate case is not necessary or in the public interest to address the issue of the AFPO credits; the Agreement does not change any rates that are currently in effect and the time and expense of preparing and litigating a general rate case in view of the recently completed proceedings in this docket militate against a complete revisitation of MP's rates.

However, Superwood contended that MP may already be earning in excess of its rate of return established in the rate proceeding and may not need to recover the AFPO credits in order to remain whole. Information was presented indicating that MP may have indeed earned slightly in excess of its allowed rate of return for the year 1988.

The Commission finds that the historical information submitted by Superwood is not a sufficient basis to establish whether MP is likely to earn in excess of its allowed rate of return in the future. If a rate case were to be filed by Minnesota Power, the financial information would likely be normalized projected data, which makes adjustment for abnormal, non-recurring items. The record shows that the earnings information submitted by Superwood is historical, non-normalized data and includes several one-time items for fuel clause timing, litigation settlements, and bankruptcy payments. The relevant evidence in the record indicates that MP is projecting to earn at a level below its allowed rate of return for 1989. This is because MP is expecting reduced power pool sales, expiration of Coyote gain, fuel clause timing, and expiration of the amortization of excess deferred taxes. Consequently, the Commission finds that in the absence of an Agreement, the threat or likelihood of a rate case in the near future is substantial and real.

The Commission also agrees with the parties to the Agreement that another general rate case so soon after rates have been established in this proceeding would not be in the public interest. The rate structures which were prescribed in the present proceeding reflect a careful balance between different classes of customers and the public interest. If the Commission were to require Minnesota Power to file another rate case, it is likely that rates would have to be restructured. Restructuring of rates could undo many of the public interest objectives which the Commission sought to achieve. A rate case would also require substantially additional expense and time for the parties as well as the administrative agencies involved.

By creating substantial disincentives for filing a rate case before January 1, 1991, and incentives for the utility to avoid a rate case before January 1, 1996, the Agreement diminishes the likelihood that a general rate case will be filed by MP before January 1, 1991 at the earliest, and possibly not until much later. The Commission therefore finds that the Agreement furthers the public interest by maintaining rate level and rate structure stability and deferring a rate case, with its attendant

administrative expenses and burdens and expense to the indefinite future.

Superwood also raised the objection that the Commission's action would constitute fixing a "rate" without having undertaken an investigation and contested case hearing. The Commission disagrees that its action constitutes fixing a "rate." The Commission frequently establishes accounting procedures which do not change rates presently, but may have future cost implications such as public utility conservation improvement program deferred debit accounts, depreciation and cost of capital. See e.g., In re Northern States Power Co., Docket No. E-002/GR-85-558 April 1, 1981). These determinations do not fix a "rate" but are effectively binding upon future commissions in establishing rates. Likewise, in the present case, the Commission's determination that the AFPO Agreement is just and reasonable does not fix a "rate" but determines a matter of cost which must be followed by the Commission when it does fix rates in the future.

The Commission has broad authority over the accounting systems that public utilities may use in conducting business. Minn. Stat. §§ 216B.10 and 216B.11. Minn. Stat. § 216B.10, subd. 3 (1988) provides: "Every public utility is required to keep and render its books, accounts, papers and records accurately and faithfully in the manner and form prescribed by the commission, and to comply with all directions of the commission relating to these books, accounts, papers and records."

Further, Minn. Stat. § 216B.25 (1988) empowers the Commission to reopen any case following the issuance of an order therein, for the taking of further evidence or for any other reason. Minn. Stat. § 216B.25 recognizes the Commission's inherent power to correct a prior determination to correct an error or irregularity. Here, the Commission finds that circumstances upon which AFPO credits were based have changed significantly and make it just and reasonable for the Commission to reopen and amend its accounting treatment of AFPO credit.

ORDER

1. The AFPO Agreement is approved as clarified. Should a sale of generating plant occur, the Company shall file, with the Commission and all parties to this proceeding, a report detailing the gain on the sale, the status of the AFPO Accounts, and the proposed distribution of any gain. Such filing shall be made within 30 days of the sale, transfer, or disposition of generating plant. Parties shall comment on the distribution of the gain within 30 days of the filing.
2. Minnesota Power shall file its report detailing the incremental capacity-related revenue items for the previous year and the status of the accumulated AFPO accounts. The report shall be filed with the Commission and all parties to this proceeding on or before January 30 of each year. The first report shall be due on or before January 30, 1990 and shall include all activity in the AFPO accounts to date.
3. Within 45 days of the elimination of AFPO Account I, Minnesota Power shall file with the Commission and all parties to this proceeding its report detailing the final accounting of

AFPO Account I and the total incremental capacity-related revenues available to the Company as compared with those for setting rates in the Company's most recent rate case.

4. The Commission hereby accepts Minnesota Power's withdrawal of its request for reconsideration of the Commission's January 11, 1989 Order in this docket.
5. This Order shall become effective immediately.

BY ORDER OF THE COMMISSION

Mary Ellen Hennen
Executive Secretary

(S E A L)